

SECRET

The seventh meeting of the team set up to review the strategies for the Group's Tobacco activities was held on 22nd October 1986.

Present: Mr. P. Sheshy, Mr. B.P. Garraway, Mr. E.A.A. Bruell,
Mr. P.J. Ricketts, Mr. D.L. Slobom, Dr. R. Salter
(Secretary).

Mr. A.L. Heard was in attendance for items 1-8.

Mr. G.L. Dennis was unable to attend.

1. The minutes of the meeting held on 24th April were agreed.
2. It was noted that further investigation of the opportunity to buy tobacco from the US stockpile had led to the conclusion that this would not show significant advantages to BAT and the opportunity had not been pursued.
3. Mr. Heard presented a paper on the funding of R&D. It was noted that the majority of the R&D effort (costing around £30m) was funded by the company in which the work was done. There was a free interchange of the information arising from this work through a common database and it had been decided that it would be inefficient to try to make charges between companies for this information.

However, there was about £2m of work in Southampton and £0.55m of work in Souza Cruz which was classified as fundamental research of a type which was essential but which was not carried out in the other R&D departments.

It was agreed that the cost of the work in Souza Cruz should be carried in that company but that the £2m of expenditure in Southampton should be covered by the other companies. It was agreed that a reasonable allocation would be £0.5m each to be paid by BATCo. and BATUS, £0.4m each from BATIG and Imasco but only £0.2m from Amatil (taking into account the relatively low volumes of cigarette sales in Amatil).

It was agreed that BATCo. should negotiate payments on this basis for 1987.

It was also agreed that BATCo. should check back with the Strategy Team in future years, to agree both the level of expenditure on fundamental work and also the allocation of the charges.

4. It was agreed that the current level of R&D effort was generally adequate to meet the requirements of the Tobacco activity.

However, it was suggested that Souza Cruz might give further consideration to the possibility of commissioning work with NPI on the application of biotechnology to developing specific characteristics in tobacco.

304017415

5. It was noted that Imasco had questioned whether more effort should be applied to attempting to develop a "safe" cigarette and to investigating or commissioning outside work to investigate factors influencing the susceptibility of individuals to cancer. In support of their argument, they had suggested that competitors were undertaking this type of work.

Mr. Bruell said that this subject had been debated at length and it had been decided that it was not likely to be a rewarding line of investigation. It was also noted that if a competitor did succeed in achieving a break-through on classifying factors associated with the susceptibility to cancer, this information would be freely available to everyone.

The Chairman asked Mr. Bruell to provide a brief note on this so that he could respond to Imasco.

6. It was agreed that Mr. Bruell would also provide Mr. Garraway with a breakdown of the total Group expenditure on Tobacco R&D, for possible use within the Annual Report and Accounts.

7. It was noted that ATP Inc., the company that had developed Favor was in financial difficulties and could fail. BATCo. had a continuing interest in the possible use of their filter technology but ATP were not prepared to sell or licence their technology and had offered instead to undertake a joint development.

BATCo. had decided that it would be preferable to wait until the company failed, at which time both the technology and the relevant people could become available.

While it was agreed that it would be inappropriate to enter into a joint venture with ATP, it was suggested that an alternative course of action could be to acquire ATP outright.

It was agreed that Mr. Bruell should ask Mr. Long to evaluate this possibility, in conjunction with BATUS.

8. It was noted that the engineering study to design the prototype plant for APEX was due for completion by 4th November. Present indications were that, because of additional safety features that had needed to be introduced, the cost would be £1.2m rather than the £0.7m originally estimated. However, although there would also be an additional cost on the full size plant, the increase would not be pro rata.

9. Mr. Bruell reported that action was in hand to rationalise the DIET tobacco expansion facilities in the UK and Germany but possibilities for carrying out contract work for other Group companies was also being investigated.

10. Mr. Garraway reported that a first meeting had been held of the team to assess the potential for European Manufacturing Rationalisation. The team was due to meet again on 1st December and was aiming to make recommendations by mid-January.

304017416

1...

Mr. Bruell plan
provide this for
Chairman

Mr. Bruell
plan, should
be done
Mr. Davis

11

11. The Chairman presented a paper summarising the current position in the USA on Barclay. Although the product now has the Actron-Plus filter and a rating of 3mg, progress in the market had been relatively modest. However, it was felt that there was considerable goodwill in the Barclay name which would be used as the basis for a Barclay Lights product to compete with Marlboro Lights. This product would have a conventional filter.

12. Mr. Bruell said that the Barclay Lights product could also be of interest in Europe as a potential competitor to Marlboro Lights.

Progress on the existing Barclay product had been limited in Europe. The product was still based on the old Actron filter as research in Switzerland had shown that, now that the harshness had been eliminated from the product, customers preferred it to products incorporating the Actron-Plus filter which had been considered too mild and too hard to draw. Despite the limited progress, Barclay was still holding its own and work was continuing to obtain agreement to reduced ratings on the packs. In terms of market share, the major disappointment was in Germany and ways to overcome this would be considered further.

13. The Chairman was disappointed that there had not been more progress in introducing Actron-Plus technology into Europe and he will be discussing this with Brown & Williamson.
14. Mr. Bruell drew attention to problems being encountered in the Middle East where a video attacking Barclay had been circulated to Government Ministers. Although there was no firm evidence, it was suspected that the video may have been originated and distributed by people acting on behalf of Philip Morris.

It was agreed that:-

*Don't
in chair*

- (a) Mr. Bruell should ask Mr. Cardwell to obtain evidence (either directly or through investigators) as to the source and distribution of the video.
- (b) Mr. Bruell would take legal advice and would then recommend what action if any should be taken against Philip Morris.
- (c) The Chairman will see Mr. Fritchard when he is in London on 24th October and will agree what action should be taken to restore Barclay's position in the market (e.g. by launching products based on Actron-Plus).
15. It was noted that the distribution of the video had occurred at a time when there had been good industry co-operation in negotiations with Governments and it was essential that strong action should be taken to make it clear to Philip Morris that action of this type could be potentially very damaging not only to the industry but also to Philip Morris themselves.

304017417

/...

16. Mr. Ricketts reported that an evaluation of Skandinavisk by Chase Manhattan had suggested that if B.A.T. Industries wished to acquire the outstanding shareholdings, a reasonable price would be £370m, representing a P/E of 12.8. This compared with an asset value of around £200m.

It was agreed that further work should be carried out to establish possible ways in which the Tobacco business of Skandinavisk might be acquired, possibly by acquiring the whole business and then divesting the non-Tobacco activities. Ways for reducing any goodwill write-off should also be considered.

Mr. Slobon was asked to prepare a paper for the Chairman outlining possible approaches that might be taken.

17. The Chairman presented a paper summarising the current position regarding exports from Brown & Williamson to the Japanese market. This showed that sales were now running at 75m/month. Mr. Bruell also reported encouraging results for an American type JPS brand, which was running well ahead of budget.

Following the announcements of further moves to reduce the tariffs imposed on imports, there could be an opportunity for a major increase in the market shares for foreign brands, and Brown & Williamson had been asked to consider possible ways for mounting a major attack on the market, and to consider with Mr. Long how the initial expenditure might be capitalised rather than charged to revenue.

Although it was accepted that the initial opportunity is likely to be for marketing, it was suggested that the possibility of manufacturing in Japan should also be considered as a longer term possibility.

18. Mr. Bruell reported that it had been decided not to proceed with the investment which had previously been proposed in West Africa.

There had been a favourable reaction from Turkey where it appeared that the Government were looking for a proposal which would allow Tekel to have a 30% share in the business but where foreign shareholders would be allowed to have control. Current indications were that the initial investment required from BATCo. would be of the order of £13m with a further £6m required for the acquisition of a shell factory. BATCo. would be preparing a paper for the CPC within a week, asking for guidance as to the acceptability of the approach which it was proposed to take in the negotiations.

It was noted that the quality of tobacco being obtained from China had improved considerably and more was being bought. Negotiations were proceeding on the project for South China.

BATCo had not accepted the view that there was a need for better agency representation in Italy. It was agreed that this question should be reconsidered with Dr. Brichsen in Spring 1987, at which time there should be a critical look at the comparisons with the performance of Philip Morris and RJR in Italy.

It was noted that BATCo. were continuing to evaluate Greece as a potential new market. Portugal had also been considered but was not thought to have good prospects for investment.

/...

304017418

19. It was agreed that it would be of advantage to BAT for further countries to introduce a requirement for warning notices on cigarette packs. It was also agreed that discreet encouragement in this direction might be given to the Governments of Ghana, Honduras, Sierra Leone and Uganda.

20. Mr. Bruell reported that difficulties were being experienced in setting up a conference on epidemiology as a means for promoting the smoking compendium. There were a number of similar meetings planned and the putative sponsors (The Fraunhofer Institute) were not enthusiastic about their ability to mount another one. Dr. Thornton is continuing his discussions with Fraunhofer but is also considering an alternative sponsoring body from Canada.

It was agreed that this venture should continue to be given a high priority. There was mounting evidence of a groundswell of opinion against excessive anti-smoking pressures and it would be helpful for the Group to take advantage of this trend.

- H. L. in
Ch in plan
discuss*
21. It was agreed that Mr. Bruell would arrange a meeting with the Chairman and Mr. Baker to discuss other ways in which both BAT and the industry as a whole might take a more positive stance against the anti-smoking lobby.

22. It was noted that the team set up to consider the stance which B.A.T Industries should take on tax harmonisation in Europe was due to meet again on 22nd/23rd October. The object of this team was to formulate a form of proposal that would be acceptable both to the industry and to the monopolies and which would assist in the further penetration of current monopoly markets.

- H. L. in
Ch in plan
discuss*
23. Mr. Bruell drew attention to the high cost (£0.5m) of an exercise which they had been advised was necessary to eliminate material from existing research files which might be detrimental to the Group if it was required to be produced in an American court. It was agreed that Mr. Bruell would arrange for Mr. Baker to see the Chairman on this.

RS/DJA
23rd October 1986

304017419